

Fixed income Monthly Update | April 2018

Setting the scene

Highlights from last month

Q2 2018 Bond Calendar; Nothing has changed. The Debt Management Office (DMO) released its bond issuance calendar for the second quarter of 2018 which affirmed our views in our March Fixed Income update **‘Dovish Influences Kick in’** that FG’s increasing preference for external borrowing will continue to drive tamer domestic borrowings over the rest of the year. From the calendar, FG intends to borrow ₦220 billion split across the 5-year and 7-year of ₦70 billion apiece as well as ₦80 billion worth of 10-year bond. FG’s planned bond issuance for Q2 2018 is 10% and 43% lower than actual (₦244.7 billion) and planned (₦385 billion) bond issuance in Q1 2018. However, given that ₦300 billion worth of FGN bond is staged to mature in May 2018, the calendar suggests that FG will be net repaying ₦80 billion worth of FGN bonds over Q2 2018. Aside, the calendar phased out the 2021 FGN bond by introducing a new instrument for the 5-year (2023). To our minds, having borrowed ₦561.05 billion worth of 2021s, we think FG has maxed out on its issuance of this security.

A dovish CBN. For the second consecutive month, CBN failed to roll over its maturing OMO bills by net repaying ₦70.8 billion in April (vs net repayment of ₦182.4 billion in March). This sits well with our views in last month’s edition that stability in USDNGN, downtrend in inflation, and elevated liquidity levels would prompt CBN to reduce its pace of liquidity mop up and steer a cut in OMO rates. As posited, CBN sold OMO bills just three times in April and cut OMO rates by 165bps and 235bps to 10.95% and 12.05% for the 90 Day and 250 Day paper respectively.

Bond yields sink further. On the other hand, bond yields at the secondary market were prostrated by FG’s aversion towards naira denominated debt and waning inflationary pressures (March headline inflation fell 99bps to 13.34%) as average bond yields dipped over 100bps to 12.62% at the secondary market—its lowest since August 2016 but ended the month of April at 12.96% (-68bps MoM). Meanwhile at the bond auction, despite pent up demand (bid to cover of 2.92x), FG’s bond issuance of ₦90 billion was largely in line with the script (Planned borrowings for April: ₦90 billion). As a result, average marginal clearing rates dipped 68bps to 12.85%.

Treasury bill yields submerge. Given burgeoning liquidity levels over the prior month—emanating from CBN’s increasing tolerance for naira liquidity and FG’s tamer domestic borrowings—secondary market treasury bill yields were submerged to its lowest levels in over 20 months (-252bps MoM to 12.36% in April) following strong paper demand due to excess monies in the system and investor’s anticipation for further plunge in yields. This spilled into the primary market as April’s T-bills auction were four times oversubscribed, with ~85% of the demand stemming from 364-day paper. Regardless, FG net repaid ₦109.7 billion which is in line with its plan to refinance maturing T-bills with the proceed of the \$2.5 billion Eurobond raised earlier in the year. Consequently, for the ninth consecutive month, average stop rates at the PMA dipped (70bps MoM to 12.07%).

Table 1: Net PMA Issuances/ (Maturity) in ₦'billion

	OMO Issuances	NTB 91-day	NTB 182-day	NTB 364-day	Total	Bond 5-year	Bond 7-year	Bond 10-year	Bond 20-year	Total	Grand Total
Jan-17	700.5	22.7	-20	133	135.7	35	-	74.9	105.1	215	1,051.2
Feb-17	91.8	45.2	-	120	165.2	60	-	30	70	160	417.0
Mar-17	141.1	-24.1	-110.5	305.1	170.6	30	-	50	80	160	471.7
Apr-17	212.7	-24.2	-2.7	-43.9	-70.8	-445.3	-	34	56.3	-355	-213.1
May-17	-89.2	-16	23.4	96	103.4	10	-	35	65	110	124.3
Jun-17	-203.4	65.2	28.3	33.6	127.1	4.2	-	30.3	64.8	99.3	23.0
Jul-17	369.8	13.8	-13.3	24	24.5	3.9	-	47	55.1	106	500.2
Aug-17	117.6	-38.5	-10.4	48.5	-0.4	9.2	-	17.5	29.4	56.1	173.2
Sep-17	-25.6	-21.4	26.2	118.7	123.5	35.3	-	76.9	131.6	243.8	341.7
Oct-17	180.3	-39.1	-35.8	118.4	43.5	3	-	118.1	-	121.1	344.9
Nov-17	13.9	-29.2	-38.5	234.4	166.7	14.6	-	73.2	-	87.8	268.4
Dec-17	918.8	-	-	-	-	24.8	-	61.5	-	86.2	1,005.0
Jan-18	1,003.3	-	12.7	-	12.7	45.1	-	64.9	-	110	2,336.2
Feb-18	129.2	-	30	-	30.0	27.2	-	52.4	-	79.6	404.0
Mar-18	-182.4	16.7	-2.5	94.5	108.7	10.05	8.9	45.1	-	64.1	512.7
Apr-18	-70.8	-6.7	23.6	-126.8	-109.8	38.3	12.8	38.9	-	90	-90.6

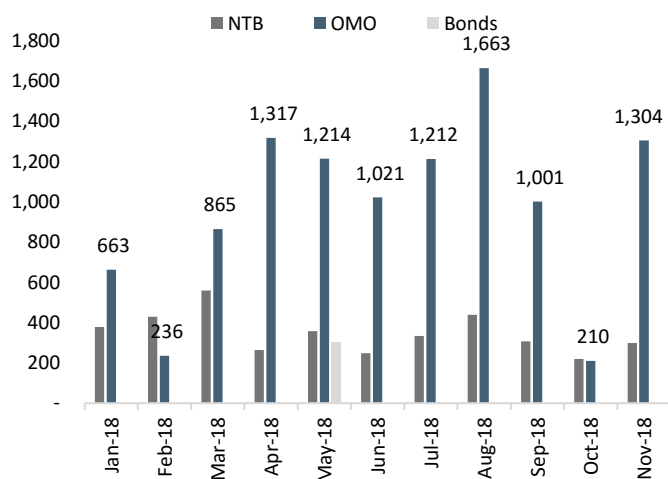
Source: FMDQ, ARM Research

Table 2: Average OMO, NTB and Bond stop rates

	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18
OMO	18.30%	18.30%	18.50%	18.80%	18.30%	18.30%	18.30%	18.20%	17.30%	17.20%	17.00%	13.90%	13.70%	13.80%	13.73%	12.02%
NTB	16.70%	16.50%	16.50%	16.60%	16.50%	16.50%	16.50%	16.40%	15.90%	14.70%	14.60%	0.00%	13.40%	13.10%	12.77%	12.08%
BOND	17.00%	16.60%	16.30%	16.20%	16.30%	16.20%	16.20%	16.80%	15.90%	15.00%	14.80%	13.20%	13.40%	13.84%	13.51%	12.83%

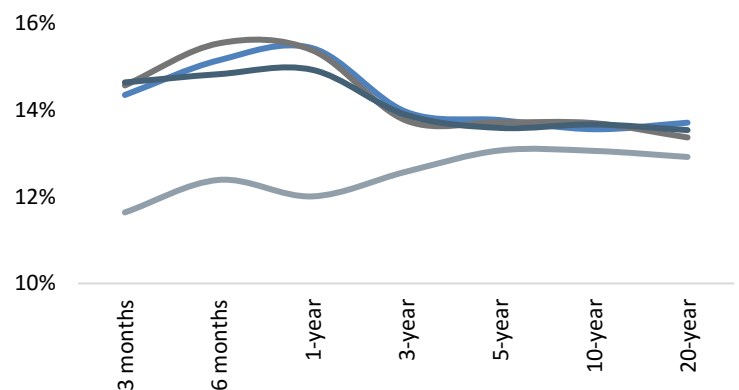
Source: FMDQ, ARM Research

Figure 1: Maturity profile over 2018



Source: FMDQ, ARM Research

Figure 2: Trend in Naira yield curve



Source: FMDQ, ARM Research

Outlook

Taking cues from recent issuance patterns, particularly in the last two months where CBN has been leaving the system awash with liquidity, we expect CBN's reluctance to issue significant amount of OMO paper to persist over the near term. Our expectation is hinged on the relative stability in the naira, elevated maturity profile in May (NTB: ₦358 billion, OMO: ₦1.2 billion, Bond: ₦300 billion) as well as CBN's increasing responsiveness to waning inflationary pressures with our prognosis pointing to an 84bps plunge in headline inflation to 12.5% in May. Given the foregoing, paper demand is likely to remain strong over the near term with knock on effect driving fixed income yields lower. More importantly, barring further shocks to inflation over the near term, our benign inflation outlook suggests a wider premium between headline inflation and MPR and sets the scene for a cut in MPR, which ushers in the gradual end to an era of elevated interest rate clime in Nigeria. On the fiscal side, given the recent jump in mean crude oil prices (+7.6% MoM to \$71.8/bbl) and stability in crude oil production, FG will be more at ease to pursue its drive of trimming high debt service cost. Thus, we anticipate further cut in paper supply which would continue to wreak havoc on investor's bargaining power, thereby driving lower marginal clearing rates at subsequent PMA auctions. In all, we are of the view that the tempered outlook for paper issuance, waning inflationary pressures, amidst expected elevated liquidity levels, provides scope for further yield downtrend. Notably, while election concerns and rise in US 10-year treasury yields above the 3% psychology level could usher FPI downturn, we believe the aggregate increase in paper demand, coupled with a dovish CBN is likely to cap any possible spike in yields.

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